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Department of the Treasury
Internal Revenue Service

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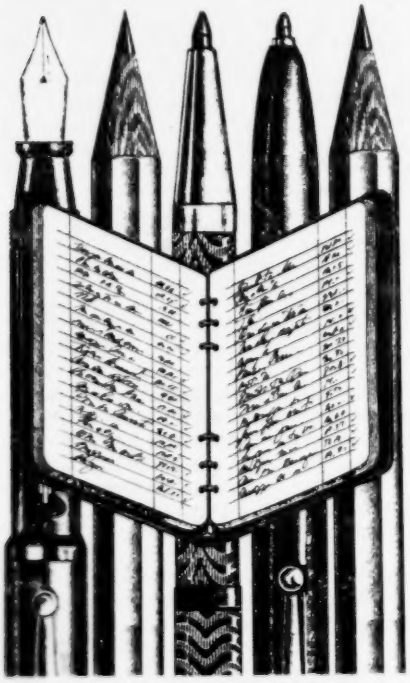
Recordkeeping for a Small Business

For use in preparing
1980 Returns



You can get the tax forms and publications referred to in this publication by writing to the IRS Forms Distribution Center listed in your Form 1040 or 1040A Instructions. Or, you can call the Tax Information number in the phone book listed under "United States Government, Internal Revenue Service."

Introduction

Everyone in a business must keep records that will help them to prepare complete and accurate tax returns and make sure that they pay only the tax they owe.

The tax law does not require any special kind of records. You may choose any system that is suited to your business and that will clearly reflect your income. Your permanent books (including inventory records) must show not only your gross income, but also your deductions and credits. In addition, you must keep the other records and data necessary to support the entries on your records and tax or information returns. Paid bills, canceled checks, etc., that verify entries on your records should be filed orderly and kept in a safe place. For most small businesses, the business checkbook is the prime source for entries in the business records.

The type of business you are in affects the kinds of business records that you will need to keep for federal tax purposes. If you are in one or more business activities and own a partnership interest in one or more businesses, you should keep a complete and separate set of records for each business.

The sample records set forth in this publication show the kinds of records that can be used by a small business operating as a sole proprietorship. Information about running your business as a partnership or as a corporation is found in Publication 541, *Tax Information on Partnerships*, or Publication 542, *Tax Information on Corporations*, which you may get from the Internal Revenue Service.

The Business Activity

A business is an activity carried on to earn a living or to make a profit. To be recognized as a business, you must have a profit motive and some type of economic activity. A profit making activity (a business) must be distinguished from an activity engaged in only for personal satisfaction.

Elements of a business. Two elements of a business are regular activities and transactions, and the production of income. If no income or a small amount of income is coupled with expenditures resulting in a loss, there may be a question as to whether a business was carried on in that year.

Having no income, however, does not stop you from deducting the ordinary and necessary expenses directly connected with or pertaining to your trade, business, or profession.

Example 1. In October 1980, you decide to enter the grocery business. Your tax year ends on December 31 each year. During November 1980, December 1980, and January 1981, you buy equipment and inventory items. You rent a building on February 1, 1981, and open for business on that date. This situation shows that you were merely getting ready to enter business in 1980. You did not actually start your business until 1981.

Example 2. You are a calendar year taxpayer and for several years have run a small upholstery business. Because of poor health, you decide to close your business in August 1980. You perform your last work in September 1980. You sell your business assets in March 1981. From this situation it is clear that you were running the upholstery business until September 1980. Depreciation of the property used in your business should end in September 1980. You must keep a record of the adjusted basis of each asset.

Setting up a new business. If you set up a new business, you are usually involved in buying single assets or groups of assets. The basis of each asset you buy is its cost. If you buy assets in groups, you must divide up the total purchase price among the items. See *Dividing the Basis* in Publication 551, *Basis of Assets*.

Buying an existing business usually does not result in the acquisition of one single asset—the business—but in the purchase of the individual assets that make up the business.

You must identify the expenditures you make in acquiring or organizing a business. This is because you may make different types of expenditures, such as items that are deductible, items which must be capitalized but may be depreciated or amortized, and items which must be capitalized that have no definite life and may never be deducted, depreciated or amortized during the life of the business.

A business asset may be tangible property such as a building or a machine, or intangible property such as a patent or franchise right.

Some examples of the ways you can get business assets are:

1) Cash purchase, or a cash down payment and a note for the rest of the purchase price;
2) Purchase in which a used asset is also traded-in;
3) Inheritance;
4) Gift;
5) Conversion of property held for personal use into a business asset;
6) Exchange for other assets; or
7) Transfer to a corporation in exchange for stock.

The basis of property you buy is usually its cost. The cost of property is the amount you pay for it in cash, debt obligations, or other property. If the asset has an expected useful life of more than one year, the cost or other basis generally is recoverable through annual depreciation deductions. Amounts you pay for your business assets are capital expenditures.

You use the basis or cost of your property to figure your gain or loss on its disposition and to figure the allowances for depreciation, amortization, and depletion. If major improvements are made to the asset, the cost is added to basis. Any casualty loss reduces basis. See Publication 534, *Depreciation*, for a discussion of how basis applies to depreciation.

Setting Up Your Records

You should set up your books using an accounting method that clearly shows your income for the accounting period that is your tax year.

Choosing a Tax Year

You must be able to figure your taxable income and file an income tax return based on a tax year.

A new taxpayer may choose a calendar or a fiscal tax year. The first tax year must be chosen on or before the time set by law (not including extensions) for the filing of a return for that year.

Tax year. A tax year is usually 12 consecutive months. It may be a calendar year or a fiscal year (including a period of 52 or 53 weeks). Also, your tax year may be less than 12 months, but it may not be more than 12 months unless you use a 52-53 week year.

Calendar year. A calendar year is 12 consecutive months ending on December 31. If you now are a calendar year taxpayer your sole proprietorship would also be on the calendar year basis.

Example. You are salaried and are reporting on the calendar year basis. If you go into business for yourself you may not change to a fiscal year basis unless you get approval from the Internal Revenue Service.

Fiscal year. A fiscal year is 12 consecutive months ending on the last day of any month other than December, or a 52-53 week year. To report on a fiscal year basis, your books must be kept on that basis.

A short period is a tax year of less than 12 months. A short period return is treated as a return for a full tax year.

If your records are not adequate or you have an accounting period that does not qualify for a fiscal year, your tax year will be the calendar year. Here, choosing a fiscal year will be treated as a change in your annual accounting period. You will need prior approval from the Internal Revenue Service, as discussed in Publication 538, *Accounting Periods and Methods.*

Choosing an Accounting Method

You may choose between two basic accounting methods: the cash method and the accrual method. In addition you may also choose special accounting methods such as the installment and deferred-payment methods. You may also use any combination of these methods that apply to your business needs as long as your income is clearly shown.

Inventories are needed to reflect income when the production, purchase, or sale of merchandise is an income producing factor. If inventories are needed to reflect income correctly, only the accrual method of accounting may be used for purchases and sales.

You must be consistent from year to year and figure your taxable income for the method of accounting regularly used in keeping your books, if that method clearly shows your income. Any method of accounting that shows the consistent use of generally accepted accounting principles according to accepted practices in your trade or business ordinarily will be regarded as clearly showing income. A method of accounting will clearly show income only if all items of gross income and all deductions are treated the same way from year to year.

The cash method. Under this method you report income when actually or constructively received, and you report expenses when actually paid.

Constructive receipt occurs when an amount is credited to your account or made available to you on demand. The amount must be available to you without any major restriction as to the time or manner of payment.

Example 1. Interest credited to your bank account in December is included in your gross income for that year and not for the following year when it is withdrawn or is entered in your passbook.

Example 2. Interest coupons matured and payable in one year but not cashed until the following year are included in income for the year in which they mature and are payable.

Holding checks or similar property from one tax year to another does not put off payment of tax on the income. Such income is properly included in the year when the checks or other property are set aside for you and are subject to your demand.

Example. A check or payment received on December 31, 1980, but not cashed or deposited until January 3, 1981, is included in your gross receipts for 1980, the year in which you actually received the amount.

Example. You received and deposited a check dated December 28, 1980, on January 2, 1981, for payment of goods. This amount must be included in gross receipts for 1981, the year the check is received.

Expenses paid in advance. Special treatment is given to payment of expenses that cover periods of more than one year. For example, the payment in one year of an insurance policy that extends over 3 years is figured in equal amounts over the period the insurance is in effect.

The accrual method. Income under the accrual method is reported in gross income when you earn it, even though you may receive the payment in a later year. It is not the actual receipt of payment but the right to receive it that is important. All events fixing the right to receive the income must have occurred. You must also be able to correctly figure the amount.

Example. A dealer operating on a calendar year basis sold a radio in November 1980. The customer was billed 2 days later but the dealer did not receive payment until February 1981. The dealer includes the amount of the sale in income for 1980. The income was earned in that year.

Under this method, expenses are deducted when they are incurred rather than when they are paid. All events fixing the liability must have occurred. You must also be able to correctly figure the amount of expense.

Example. You are a calendar year taxpayer and in December 1980, you buy office supplies. You are billed in the same month, but make payment in January 1981. The expense is deductible in 1980 because the liability was incurred in that year.

Combination of methods. You may use any combination of accounting methods if the combination is applied consistently and clearly reflects income. This combination of methods is known as a ***hybrid method.***

Cash or accrual. If you use the accrual method of accounting for purchases and sales you may use the cash method in figuring all other items of income and expenses. However, if you use the cash method in figuring gross income from your trade or business, you must use the cash method for business expenses. Similarly, if you use the accrual method for business expenses, you must use the accrual method for all items affecting gross income from your trade or business.

Business and personal items may be accounted for under different methods of accounting. Thus, you may figure the income from your business under an accrual method even though you use the cash method for personal items.

If you own more than one business you may use a different method of accounting for each business as long as the method used for each clearly reflects income. Each business must have a complete and separate set of books and records kept for it.

Example. You run a personal service business and a manufacturing business. You may use the cash method for the personal service business but you must use the accrual method for the manufacturing business because inventories are important in accounting for your income.

Changing your method of accounting. Once you have set up your accounting method, you can not change it without first getting the consent of the Internal Revenue Service. A change in the method of accounting includes a change not only in the overall system of accounting, but also in the treatment of particular material items. For examples of changes requiring consent and the rules on how you get consent, see Publication 538, which you may get from the Internal Revenue Service.

A Single- or Double-Entry Bookkeeping System

You must decide whether to use a single- or a double-entry bookkeeping system. The single-entry system of bookkeeping is the simplest to maintain, but, it may not be good for everyone. You may find that the double-entry

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system is better because it has built-in checks and balances to assure accuracy and control.

Single-entry bookkeeping is a system that is based on the income statement and not on the balance sheet. It can be a simple system, and very practical if you are starting out in a small business. For tax purposes, the system records the flow of income and expenses through the use of a daily summary of cash receipts, a monthly summary of r ceipts, and a monthly summary of disbursements.

Double-entry bookkeeping uses journals and ledgers. Transactions are first entered in a journal and then summary totals are posted to ledger accounts to show income, expenses, assets, liabilities, and net worth. Income and expense accounts are closed at the end of each accounting period. Asset, liability, and net worth accounts are kept open on a permanent basis.

The double-entry system is self-balancing. Since business transactions are an exchange of one thing for another, double-entry bookkeeping shows this effect by recording every transaction as a debit entry in one account and as a credit entry in another. Under this system, after the journal entries are posted to the ledger accounts, the total of the amounts entered as debits must equal the total of the amounts entered as credits. If the accounts do not balance an error has been made and steps can be taken to find and correct the error.

At the end of each accounting period financial statements may be prepared. These statements are generally the income statement and the balance sheet. The income statement reflects current operations for the year. The balance sheet shows the financial position of the business in terms of assets, liabilities, and net worth at an exact point in time.

Additional information. You can get more information on accounting systems and on basic accounting terms and procedures from various Small Business Administration publications, such as, Small Business Management Series No. 32, *Financial Record Keeping for Small Stores*. This may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, or from the U.S. Government Printing Office in your area.

Effective Records

Good records are needed for good management. The following list shows what good records can do for you.

Identify source of receipt. The money or property you receive can come from many sources. Your records can identify the source of your receipts, so you can prove that they are from nonbusiness sources, or that they may not be taxable.

Keep track of deductible expenses. Expenses may be forgotten when you prepare your tax return, unless you record them when they occur.

Figure depreciation allowance. You should record the assets you can depreciate in a permanent record. Without a record of the cost and other information on your assets, you cannot figure your depreciation deductions. If the assets are sold or become fully depreciated, or if capital improvements are made to them, only a permanent record will show how much of their cost you have not recovered. The concept of depreciation is explained later under *Depreciation deduction*.

Take advantage of capital gain and loss laws. If your records are good and complete, they will show the date an asset was acquired, what it was used for, and whether it was sold, traded, destroyed, or otherwise disposed of. With this information you may be able to use the capital gain or loss laws. You also may be allowed to put off paying tax on certain gains, or to deduct 100% of certain losses that otherwise would not be deductible or would be only partly deductible.

Determine your earnings for self-employment tax purposes. The self-employment tax is part of the system for providing social security coverage for people who work for themselves. The social security benefits that you can get when you retire, or are disabled, or that your family can get when you die, depend on how much you earn. Your records should show how much of your earnings you pay self-employment tax on.

Support items reported on your income tax return. If your income tax return is examined by the Internal Revenue Service, you may be asked to explain the items reported. Adequate and complete records are always supported by sales slips, invoices, receipts, bank deposit slips, canceled checks, and other documents.

Support items on other tax returns. You may have to pay for several types of federal taxes, depending on your type of business. If any of these returns are examined, you may be asked to explain the items reported. A complete set of records will speed up the examination. Publication 509, *Tax Calendar for 1981*, has a tax calendar and check list with due dates of various taxes that might apply to your business. You may get a copy of this publication from the Internal Revenue Service.

Employment taxes. If you hire one or more employees to help you run your business, you will probably have to withhold federal income tax from their wages. You may also be subject to the Federal Insurance Contributions Act (social security) and the Federal Unemployment Tax Act (unemployment insurance).

Employer identification number. Every employer subject to employment taxes must have an employer identification number. You can get your application Form SS-4, *Application for Employer Identification Number*, from the Internal Revenue Service or the nearest Social Security Administration office.

If your Form SS-4 shows that you are starting a new business, the Internal Revenue Service office processing your application will tell you how to get a copy of Publication 454, *Your Business Tax Kit*. This kit includes samples of the federal tax forms that you will need.

For information on employment taxes and reporting requirements, see Publication 539, *Withholding Taxes and Reporting Requirements*.

An exhibit of an employee payroll record is included in the *Sample Record System* at the end of this publication.

Recordkeeping

A typical recordkeeping system for a small business might include the following:

- Daily Summary of Cash Receipts
- Monthly Summary of Cash Receipts
- Check Disbursements Journal
- Depreciation Record
- Employee Compensation Record
- Business Checkbook

Books. You are not required to keep your records in bound books. Records are adequate if they show current income on the basis of an annual accounting period.

Keeping records. You must keep the books and records of your business available at all times for inspection by the Internal Revenue Service. Your records must be kept as long as they may be needed in the administration of any Internal Revenue law.

Retain copies. Keep records that support an item of income or deduction on a return until the statute of limitations runs out. Usually, the statute of limitations for an income tax return ends 3 years after the return is due or filed, or 2 years from the date the tax was paid, whichever occurs later.

If you are an employer, you must keep all your employment tax records for at least 4 years after the date the tax becomes due or is paid, whichever is later.

Keep records that verify your basis in property for as long as they are needed to figure the basis of the original or replacement property. Occasionally, Congress passes laws giving relief to taxpayers in certain situations. You will be able to take advantage of these laws only if your records show that you are eligible. Your records can prove that you had the needed transactions in earlier years.

You should keep copies of your filed tax returns. They help in preparing your future tax returns, and in making computations if you later file a claim for refund. They may also be helpful to the executor or administrator of your estate, or to the Internal Revenue Service if your original return is not available.

For more information about recordkeeping requirements, the *Guide to Record Retention Requirements* may be purchased from the Superintendent of Documents, U.S. Government

Printing Office, Washington, D.C. 20402. It may also be available at G.P.O. bookstores throughout the country.

Sample Record System

The books that have been described are used in the bookkeeping system illustrated on the following pages. This is a single-entry system used by Henry M. Brown, the sole proprietor of a small automobile body shop. Henry, who uses part-time help and has no significant inventory, uses the cash method of accounting.

These sample records ***should not*** be viewed as a recommendation that your records be kept this way. They are used only to show the simple form in which business records can be kept.

The following explanations are keyed to the numbers and letters on the sample records and the 1980 Schedule C (Form 1040). The bracketed numbers help you to key certain portions of the discussion with certain illustrations. The bracketed letters and the related discussions identify and explain the progession of certain transactions throughout the sample system.

The design of Schedule C may change from year to year. You should make sure that all items are entered on the correct line of the current form.

[1] Daily Summary of Cash Receipts. This summary records cash sales for the day and accounts for the cash over and above the amount in your Change and Petty Cash at the beginning of the day.

You may take the Cash Sales entry from your cash register tape, or if you have no cash register, you may simply total your cash sale slips and any other cash received for the day.

[A] The total of cash receipts ($67.80) for January 2, 1980, is taken from the Daily Summary of Cash Receipts and is entered in the Monthly Summary of Cash Receipts. This gives you the total monthly receipts from which total monthly taxable income is figured.

[2] Monthly Summary of Cash Receipts. This provides the income activity for the month showing such items as net sales, sales tax, receipts, and deposits in separate columns. A single figure can be arrived at for each account in its separate column. For tax purposes, the most important total derived from the Monthly Summary of Cash Receipts is the amount of monthly taxable transactions shown as net sales.

[B] The total monthly net sales ($4,620.98) is carried to the Annual Summary to figure gross receipts.

To figure total monthly net sales, reduce the total monthly receipts by the actual amount of sales tax to be turned over to the state. You may not take a deduction for the sales tax turned over to the state because you have not included this amount in income.

Another way to handle sales tax is to include the total sales tax collected in your gross receipts and take a deduction for sales taxes in the amount and at the time they are paid over to the state. Because the various states and local jurisdictions have different requirements for the collection of sales taxes, you should contact the taxing authorities in your area for sales tax regulations.

[3] Check Disbursements Journal. You should enter checks drawn on your business checking account in your Check Disbursements Journal each day. All checks should be prenumbered and every check number should be accounted for in the narrow column provided for check numbers on the journal.

The more frequent expenses are set up with their own headings across the sheet. You should enter in a separate account column expenses that normally require comparatively numerous or large payments each month, such as materials, supplies, and rent.

Personal or nonbusiness checks should not be drawn on the business account. If they are drawn on the business account you should record them in the journal, even though they may be nondeductible as business expenses. You may enter under the general account column small expenses that normally have only one or two monthly payments, such as for license and sales tax.

[C] The monthly total of material and supplies ($1,083.50) is carried to the Annual Summary of Schedule C Entries. Similarly, monthly expenses for trucks, telephones, etc., are entered in the appropriate columns of this summary.

Petty cash fund. You can use a petty cash fund to make small payments without having to write checks for small amounts. Each time you make a payment from this fund, you should make out a petty cash slip and clip it to your receipt as proof of payment. You should set up a fixed amount in your petty cash fund ($30.00 in the illustrated example). The total of the unspent petty cash and the petty cash slips should equal the fixed amount of the fund. When the total of petty cash slips approaches the fixed amount, you should bring the cash in the fund back to the fixed amount by writing a check to "Petty Cash" for the amount of the outstanding slips. This will restore the fund to its fixed amount. The slips are then summarized and entered in the proper columns in the monthly check disbursements journal.

[4] Annual Summary for Schedule C Entries. This annual summary of monthly income and expense totals provides final annual amounts to be entered on your tax return. The annual summary is taken from the total of monthly income items such as [B], which is taken from the Monthly Summary of Cash Receipts, and from monthly expenditures like [C], which is taken from the Check Disbursements Journal. As in the case of the Check Disbursements Journal, each major expense is kept in a separate column.

[D] The gross receipts total ($47,196.88) arrived at on the annual summary is entered under Part I, line 1 of Schedule C.

[E] The annual expense total for materials and supplies ($9,872.11) is carried from the annual summary and entered under materials and supplies on Schedule C-1 to determine the cost of operations. This total is then entered in Part I, on line 2 of Schedule C.

There are no inventories in this example since the buying of parts and supplies is on a per job basis. A business having significant inventories must complete the appropriate lines dealing with inventory on Schedule C-1.

Annual totals for rent, wages, taxes, and interest are entered on the appropriate lines of Schedule C. Other annual business expense totals are entered as separate items under line 32 of Schedule C.

[5] Record of Depreciable Property. Another major item entered on Schedule C is the depreciation allowed on the depreciable assets used in your trade or business. The sample depreciation record shows examples of items depreciated on the ***straight line*** and ***declining balance*** methods.

You must take depreciation in the year in which it is sustained. You can not deduct in any one year the allowable depreciation that you failed to take in a prior year. The amount of depreciation that you may claim for the tax year is shown in your depreciation record under *Depreciation This Year.*

[F] The amount of the depreciation for the tax year ($1,640.32) is carried from the depreciation record to Schedule C-2. The total depreciation ($1,640.32) claimed for the tax year is then carried from the Schedule C-2 to Part II, Line 13 of Schedule C (Form 1040).

Depreciation deduction. The deduction for depreciation may only be taken for property used in your trade, business, or held for the production of income. You may recover your cost or other basis of the depreciable property during its estimated useful life. Before you can figure depreciation you must know an asset's estimated useful life, its basis, and its estimated salvage or trade-in value.

You may use any reasonable method that is consistently applied to figure depreciation. The two methods most commonly used are the straight line and the declining balance methods. To determine what types of property qualify for a certain method of depreciation, see Publication 534, *Depreciation.*

Under the ***straight line method,*** the cost or other basis of the property less its estimated salvage value is deductible in equal amounts over the estimated useful life of the property. This allowance for depreciation for the tax year is figured by dividing the adjusted basis of the property (less salvage value) at the beginning of the tax year by the remaining useful life of the property.

Under the ***declining balance method,*** a depreciation deduction is taken the first year the property is in use, and a gradually smaller allowance is taken in each of the following years. The depreciation taken each year is subtracted from the basis of the property before figuring the next year's depreciation, so

that the same depreciation rate is applied to a smaller or declining balance each year.

The special rules for figuring other methods of depreciation, such as the sum of the years-digits method, the requirements for figuring additional first year depreciation, and the detailed explanations of useful life and salvage value are in Publication 534. For a detailed discussion of allocation of cost, see Publication 551, *Basis of Assets,* and for determining qualifying property for investment credit, see Publication 572, *Investment Credit.* You can get a copy of these publications from the Internal Revenue Service.

[6] An Employee Compensation Record is kept for each employee. It records the number of hours worked by each employee in a pay period and the individual's total pay for the period. Deductions withheld are recorded to show the computation of the employee's resulting net pay. It also records monthly gross payroll [G], which is carried to your Annual Summary [4].

Detailed instructions on how to figure the amounts for deductions for social security and federal income tax withheld amounts are contained in Publication 15, *Circular E, Employer's Tax Guide,* available from the Internal Revenue Service. It also explains the rules for reporting withheld amounts on Form 941, *Employer's Quarterly Federal Tax Return,* and the requirements for depositing these amounts with Federal Tax Deposit, Form 501.

As an employer, you may be liable for Federal Unemployment Tax (FUTA). For more information, you should get a copy of Publication 15.

The Business Checkbook

The business checkbook is your basic source for keeping a record of your business expenses. It is recommended that all daily receipts be recorded here.

You should use a checkbook that allows enough space to enter enough information to determine later what money represents income and what money represents personal funds or loans deposited. You should note on the deposit slips the source of the deposit. Keep copies of all deposit slips.

You should deposit all business receipts in a business bank account and set up a petty cash fund for small expenses. All business expenses paid by cash should clearly show that they are for business purposes.

You should make all payments by check so that business expenses are well documented. Do not write checks payable to cash or to yourself unless they are drawn for personal reasons. If you must write a check payable to cash or to yourself to pay for a business expense by cash, you should include the receipt for the cash payment in your records. If you cannot get a receipt for a cash payment, you should make an adequate explanation in your records at the time of payment.

Reconciling your checking account. Before you start to reconcile your monthly bank statement, check your own figures. Begin with the balance as shown in your checkbook at the end of the prior month. To this balance add the total cash deposited during the month and subtract total cash disbursements.

You can figure the amount of your bank deposits from the monthly total in the Monthly Summary of Cash Receipts. The amount of cash disbursements is the total in the "Amount of Check" column of your Check Disbursements Journal. The result should agree with your checkbook balance at the end of the month.

If, after adding total cash deposits and subtracting total cash disbursements from last month's checkbook balance, the result does not agree with your checkbook's balance at the end of the month, you may have made an error in recording check or deposit amounts. You can find such errors by taking the following steps:

1) Add the check amounts on your check stubs, and compare that total with the total in the "Amount of Check" column of your Check Disbursements Journal. If the totals do not agree, check the corresponding individual amounts to see if an error was made in your check stub record or in the related entry in the "Amount of Check" column of your Check Disbursements Journal.
2) Add the deposit amounts in your checkbook. Compare that total with the monthly total of Daily Receipts in the Monthly Summary of Cash Receipts. If the totals do not agree, check the individual amounts to find any errors.

If your checkbook and journal entries still disagree, then recompute the running balance in your checkbook to make sure additions and subtractions are correct. When you are sure that your checkbook has no math errors, you may begin reconciling your checkbook record with the bank statement by carrying out the following steps—

1) Compare all canceled checks and other debits (such as service charges) in the *Checks or Other Debits* column of the statement. Make sure that you issued all the checks correctly and that you charged the correct amounts against your account.
2) Compare the deposits listed on the bank statement with the deposit amounts shown in your checkbook. Account for all differences. List in the first section of the reconciliation any in-transit deposits entered in your checkbook that do not appear on the bank statement. In the sample reconciliation, the deposits of $764.96 and $608.81 are in-transit deposits. Normally these will be deposits made toward the end of the month.
3) Put all the canceled checks in numerical order.
4) Compare each canceled check including both check numbers and dollar amount with the proper entry on your checkbook stubs. If correct, mark that number on the checkbook as having cleared the bank. After accounting for all checks returned by the bank, those not checked on your checkbook are your outstanding checks. List in the next section of the reconciliation these outstanding checks. In the sample reconciliation, checks numbered 88, 89, 92, and 93 were still outstanding.
5) Errors you find while carrying out any of the preceding steps should be entered in the last section of the reconciliation under Add or Subtract.
6) Enter service charges and other bank debits, determined in step (1) in the last section of the reconciliation under Add or Subtract.
7) Update your checkbook by entering items on the reconciliation but not recorded (such as service charges). At this point, the adjusted bank statement should equal your adjusted checkbook balance. If you still have differences, check to find out whether errors in the prior steps have been made.

In the illustrated sample reconciliation the checkbook balance must be decreased to reflect the net adjustment of $4.00 ($10.00 minus $6.00). On the records for Brown's Automobile Body Shop the only adjustment needed is to the Check Disbursements Journal for the $10.00 bank service charge. No adjustment is needed on the Monthly Summary of Cash Receipts because the January 7 deposit of $741.62 was correctly entered in that record.

[1]——Daily Summary of Cash Receipts

Cash Sales		66 45
Sales Tax		1 35
Total Receipts		67 80 [A]
Cash on Hand		
Cash in Register (Including unspent petty cash)		
Coins	13 75	
Bills	53 00	
Checks	24 05	
Total Cash in Register		90 80
Petty Cash Slips		7 00
Total Cash		97 80
Less: Change and Petty Cash		
Petty Cash Slips	7 00	
Coins and Bills (unspent petty cash)	23 00	
Total Change and Petty Cash Fund		30 00
Total Cash Receipts		67 80

[2] —— Monthly Summary of Cash Receipts

Date	Net Sales	Sales Tax	Daily Receipts	Deposit
1990				
[A] JAN 2	66 45	1 35	67 80	
3	194 40	3 10	197 50	
4	222 40	3 54	225 94	
5	109 02	1 73	110 75	
7	137 50	2 13	139 63	741 62
8	187 70	2 77	190 89	
9	207 56	3 31	210 87	401 76
10	128 95	2 05	131 00	
11	231 40	3 77	235 17	
12	201 28	3 21	204 49	
14	88 01	1 40	89 41	660 07
15	210 95	3 36	214 31	
16	207 41	3 30	210 71	425 02
17	221 80	3 53	225 33	
18	225 15	3 59	228 74	
19	121 63	1 94	123 57	
21	159 72	2 54	162 26	739 90
22	130 84	2 08	132 92	
23	216 31	3 45	219 52	352 74
24	220 05	3 50	223 55	
25	197 80	3 15	200 95	
26	184 48	2 94	187 42	
28	150 64	2 40	153 04	764 96
29	224 05	3 56	227 61	
30	210 14	3 35	213 49	
31	165 08	2 63	167 71	608 81
[B]	4620 98	73 90	4694 88	4694 88

[3]—Check Disbursements Journal

1980		Paid To	Ck. No.	Amount of Check	Materials	Gross Payroll	Federal Withheld Income Tax	FICA Reserve	State Withheld Income Tax
Jan	2	City Treasurer	75	35 00					
	3	Auto Parts, Inc.	76	203 00	203 00				
	4	Henry Brown	77	250 00					
	4	Void	78						
	4	Joe's Service Station	79	74 50	29 50				
	4	ABC Auto Paint	80	137 50	137 50				
	11	Henry Brown	81	225 00					
	11	John E. Marks	82	123 90		142 80	(7 30)	(8 75)	(2 85)
	16	Telephone Co.	83	27 00					
	18	National Bank	84	91 72					
	12	Auto Parts, Inc	85	472 00	472 00				
	18	Henry Brown	86	275 00					
	24	Electric Co.	87	175 30					
	25	A.J. Ignition	88	66 70	66 70				
	25	Baker's Fender Co.	89	9 80	9 80				
	25	Petty Cash	90	17 00	15 00				
	25	Henry Brown	91	225 00					
	25	John E. Marks	92	123 90		142 80	(7 30)	(8 75)	(2 85)
	25	Baker's Fender Co.	93	150 00	150 00				
	25	Enterprise Properties	94	300 00					
	25	National Bank (TAX DEPOSIT)	95	49 60			14 60	17 50	
	25	State Treasurer	96	5 70					5 70
	25	State Treasurer	97	73 90					
				3,111 52	1,083 50	285 60	-0-	-0-	-0-
		Bank Service Charge		10 00					
				3,121 52	1,083 50	285 60	-0-	-0-	-0-

[C]

Check Disbursements Journal

Employer's FICA Tax	Electric	Interest	Rent	Telephone	Truck/ Auto	Drawing	General Accounts	
							License	35 00
						250 00		
					45 00			
						225 00		
				27 00				
		18 09					Truck Loan	73 63
						275 00		
	175 30							
							Postage	2 00
						225 00		
			300 00					
17 50								
							Sales Tax	73 90
17 50	175 30	18 09	300 00	27 00	45 00	975 00		184 53
								10 00
17 50	175 30	18 09	300 00	27 00	45 00	975 00		194 53

[4] Annual Summary

	[B] Cash Receipts	[C] Materials	[G] Gross Payroll	FICA Taxes
JANUARY	46209 8	10835 0	2956 0	175 0
FEBRUARY	34787 2	7149 3	2354 0	144 3
MARCH	39420 0	7241 9	2627 1	161 0
APRIL	40770 2			
MAY	40663 2			
JUNE	41516 2			
JULY	38121 2			
AUGUST	37411 8 2			
SEPTEMBER	41265 2			
OCTOBER	38777 2			
NOVEMBER	36459 2			
DECEMBER	36565 2			
TOTALS	[D] 471968 8	[E] 98721 1	30190 0	1845 1

[5] DEPRECIATION

LINE	Description	Date Acquired	Total Cost	New or Used	Investment Credit: Amount	Investment Credit: Year Claimed	Investment Credit: Year Used	Additional First Year Depreciation	Salvage Value
	AUTO (½ OF $4,600)	1/7/78	2,300.00	N	76.66	78	78	N/A	300.00
	TRUCK	1/10/79	4418.00	N	294.55	79	79	N/A	N/A
	EQUIPMENT	7/1/79	600.00	U	40.00	79	79	120.00	-0-
	TOTALS		7318.00		411.21			120.00	300.00

for Schedule C Entries

Bank Charges	Electric	Interest	Rent	Telephone	Truck/Auto	Miscellaneous
10 00	175 30	18 07	300 00	27 00	45 00	36 00
7 50	155 10	19 09	300 00	21 50	28 50	15 90
11 25	145 81	19 09	300 00	32 10	51 30	32 15
92 50	1642 37	217 08	3600 00	324 09	571 46	713 16

RECORD

Depreciation Information				19 80		19 81	
Balance for Regular Depreciation	Life	Method	Depreciation Prior Years	Depreciable Balance Beginning of Year	Depreciation This Year	Depreciable Balance Beginning of Year	Depreciation This Year
2,000.00	SL	4	1,000.00	1,000.00	500.00	500.00	
4,418.00	DB	5	1,767.20	2,650.80	1,060.32	1,590.48	
480.00	SL	6	40.00	440.00	80.00	360.00	
6,898.00			2,807.20	4,090.80	1,640.32 [F]	2,450.48	

SCHEDULE C (Form 1040)
Department of the Treasury
Internal Revenue Service

Profit or (Loss) From Business or Profession

(Sole Proprietorship)

Partnerships, Joint Ventures, etc., Must File Form 1065.

▶ Attach to Form 1040 or Form 1041. ▶ See Instructions for Schedule C (Form 1040).

1980

09

Name of proprietor: HENRY M. BROWN

Social security number of proprietor: 458 74 0325

A Main business activity (see Instructions) ▶ AUTO REPAIRS ; product ▶ SERVICES

B Business name ▶ BROWN'S AUTO BODY SHOP

C Employer identification number: 9 9 9 9 9 9 9 9 9

D Business address (number and street) ▶ 215 AMHERST AVENUE
City, State and ZIP Code ▶ NEWARK, NEW JERSEY 07103

E Accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶

F Method(s) used to value closing inventory:
(1) ☐ Cost (2) ☐ Lower of cost or market (3) ☐ Other (if other, attach explanation)

C

	Yes	No
G Was there any major change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation.		
H Did you deduct expenses for an office in your home?		X
I Did you elect to claim amortization (under section 191) or depreciation (under section 167(o)) for a rehabilitated certified historic structure (see Instructions)? (Amortizable basis (see Instructions) ▶)		X

Part I Income

[D] 1 a Gross receipts or sales	1a	47,196 88		
b Returns and allowances	1b			
c Balance (subtract line 1b from line 1a)			1c	47,196 88
[E] 2 Cost of goods sold and/or operations (Schedule C–1, line 8)			2	9,872 11
3 Gross profit (subtract line 2 from line 1c)			3	37,324 77
4 Other income (attach schedule)			4	—
5 Total income (add lines 3 and 4) ▶			5	37,324 77

Part II Deductions

6 Advertising			31 a Wages	3,010 00	
7 Amortization			b Jobs credit		
8 Bad debts from sales or services			c WIN credit		
9 Bank charges	92	50	d Total credits	—	
10 Car and truck expenses	571	46	e Subtract line 31d from 31a		3,010 00
11 Commissions			32 Other expenses (specify):		
12 Depletion			a FICA		184 51
[F] 13 Depreciation (explain in Schedule C–2)	1,640	32	b FUTA		102 34
14 Dues and publications			c License		35 00
15 Employee benefit programs			d Miscellaneous		313 52
16 Freight (not included on Schedule C–1)			e		
17 Insurance			f		
18 Interest on business indebtedness	217	08	g		
19 Laundry and cleaning			h		
20 Legal and professional services			i		
21 Office supplies			j		
22 Pension and profit-sharing plans			k		
23 Postage	40	00	l		
24 Rent on business property	3,600	00	m		
25 Repairs			n		
26 Supplies (not included on Schedule C–1)	129	34	o		
27 Taxes	92	96	p		
28 Telephone	324	09	q		
29 Travel and entertainment			r		
30 Utilities	1,642	37	s		

33 Total deductions (add amounts in columns for lines 6 through 32s) ▶	33	11,995	49
34 Net profit or (loss) (subtract line 33 from line 5). If a profit, enter on Form 1040, line 13, and on Schedule SE, Part II, line 5a (or Form 1041, line 6). If a loss, go on to line 35	34	25,329	28

35 If you have a loss, do you have amounts for which you are **not** "at risk" in this business (see Instructions)? ☐ Yes ☐ No

SCHEDULE C–1.—Cost of Goods Sold and/or Operations (See Schedule C Instructions for Part I, line 2)

1 Inventory at beginning of year (if different from last year's closing inventory, attach explanation)		1	
2 a Purchases	2a		
b Cost of items withdrawn for personal use	2b		
c Balance (subtract line 2b from line 2a)		2c	
3 Cost of labor (do not include salary paid to yourself)		3	
4 Materials and supplies		4	9,872 11 [E]
5 Other costs (attach schedule)		5	
6 Add lines 1, 2c, and 3 through 5		6	9,872 11
7 Inventory at end of year		7	
8 Cost of goods sold and/or operations (subtract line 7 from line 6). Enter here and on Part I, line 2 ▶		8	9,872 11

SCHEDULE C–2.—Depreciation (See Schedule C Instructions for line 13)

If you need more space, please use Form 4562.

Description of property (a)	Date acquired (b)	Cost or other basis (c)	Depreciation allowed or allowable in prior years (d)	Method of computing depreciation (e)	Life or rate (f)	Depreciation for this year (g)	
1 Total additional first-year depreciation (do not include in items below) (see instructions for limitation) ▶							
2 Other depreciation:							
TRANSPORTATION EQUIPMENT	1-7-78	2,300.00	1,000.00	SL	4 yrs	500	00
MACHINERY AND OTHER EQUIPMENT	7-1-79	600.00	40.00	SL	6 yrs	80	00
Tow Truck	1-10-79	4,418.00	1,767.20	DDB	5 yrs	1,060	32
3 Totals		7,318.00			3	1,640	32
4 Depreciation claimed in Schedule C–1					4	—	[F]
5 Balance (subtract line 4 from line 3). Enter here and on Part II, line 13 ▶					5	1,640	32

SCHEDULE C–3.—Expense Account Information (See Schedule C Instructions for Schedule C–3)

Enter information for yourself and your five highest paid employees. In determining the five highest paid employees, add expense account allowances to the salaries and wages. However, you don't have to provide the information for any employee for whom the combined amount is less than $25,000, or for yourself if your expense account allowance plus line 34, page 1, is less than $25,000.

Name (a)	Expense account (b)	Salaries and wages (c)
Owner		
1		
2		
3		
4		
5		

Did you claim a deduction for expenses connected with:	Yes	No
A Entertainment facility (boat, resort, ranch, etc.)?		X
B Living accommodations (except employees on business)?		X
C Conventions or meetings you or your employees attended outside the U.S. or its possessions? (see Instructions)		X
D Employees' families at conventions or meetings?		X
If "Yes," were any of these conventions or meetings outside the U.S. or its possessions?		
E Vacations for employees or their families not reported on Form W–2?		X

[6]

EMPLOYEE COMPENSATION RECORD

NAME John E. Marks
ADDRESS 1 Elm St. Newark, N.J.
PHONE 768-6075

FULL TIME ____
PART TIME X

SOC. SEC. NO. 567-03-1973
DATE OF BIRTH 12-21-51
NO. OF EXEMPTIONS Single - 1

Pay Period Ending	Hours Worked (S M T W T F S S M T W T F S)	Total Reg. Hours	Over-time	Earnings: Regular Rate	Earnings: Overtime Rate	Earnings: Total	Deductions: Social Security	Deductions: Fed. Income Tax	Deductions: State Income Tax	Deductions: Other	Net Pay
1/11/80	4 4 4 4 4 — — 4 4 3 5 4 — —	40		$3.57		$142.80	$8.75	$7.30	$2.85		$123.90
1/25/80	4 4 3 4 4 2 — 4 3 4 4 4 — —	40		$3.57		$142.80	$8.75	$7.30	$2.85		$123.90
		80				$285.60	$17.50	$14.60	$5.70		$247.80
QUARTERLY TOTALS											

[G]

Check Reconciliation as of Jan. 31, 1980

Balance shown on bank statement		1469 47
Add deposits not credited:		
1/28	764 96	
1/31	608 91	
		1373 77
		2843 24
Subtract outstanding checks:		
No. 88	66 70	
89	9 80	
92	123 90	
93	150 00	
		350 40
Adjusted balance per bank statement		2492 84
Balance shown in checkbook		2496 84
Add: DEPOSIT OF $741.62 POST		
1/7 ENTERED AS $735.62 (DIFFERENCE)		6 00
		2502 84
Subtract		
BANK SERVICE CHARGE		10 00
Adjusted checkbook balance		2492 84

Other Useful Publications

Accounting Periods and Methods	Publication 538, *Accounting Periods and Methods*
Amortization	Publication 535, *Business Expenses and Operating Losses*
Basis of Property	Publication 551, *Basis of Assets*
Corporations	Publication 542, *Tax Information on Corporations*
Depreciation	Publication 534, *Depreciation*
Employees' Withholding	Publication 539, *Withholding Taxes and Reporting Requirements*
	Publication 15, *Circular E, Employer's Tax Guide*
General Tax Information	Publication 17, *Your Federal Income Tax*
	Publication 334, *Tax Guide for Small Business*
Important Dates	Publication 509, *Tax Calendar for 1981*
Investment Credit	Publication 572, *Investment Credit*
Partnerships	Publication 541, *Tax Information on Partnerships*
Self-Employment Tax	Publication 533, *Self-Employment Tax*